



**June 27, 2001**

**Jeffrey Berg  
Acting Director  
Community Development Financial Institutions Fund  
U.S. Department of the Treasury  
601 13<sup>th</sup> Street NW.  
Suite 200 South  
Washington, DC 20005**

**Dear Mr. Berg:**

The Enterprise Corporation of the Delta (ECD) is pleased to submit its comments to the Community Development Financial Institutions Fund (CDFI) on its Guidance, New Markets Tax Credit Program (Guidance). We are also submitting comments to the Internal Revenue Service (IRS) on its Advance Notice of Proposed Rulemaking (ANPR). In the Guidance CDFI requested comments on a number of pending issues. The following comments are our views on the issues CDFI raised and on other issues we believe are important.

ECD is a not-for-profit CDFI. Our core business has been to provide commercial financing to businesses in the Delta region of Arkansas, Louisiana and Mississippi. Almost all of the census tracts we serve will be qualified areas under the New Markets Tax Credit (NMTC) Program. Since our inception in 1994 we have provided \$32 million in financing to businesses in this region.

We see the NMTC Program potentially helping us raise a significant amount of additional capital that we can use to continue and expand our commercial lending and investing activities. In implementing the program CDFI should attempt to ensure that the program achieves its objectives. In reading the Guidance there are several issues we think CDFI should consider:

1. Under section IV. Eligibility, the Guidance requires that at the time of application the entity must be duly organized. It may not prove to be reasonable to require that the applicant go to the expense of becoming duly organized with no certainty that the purpose of it being (i.e. to use NMTC funds) will actually happen. Requiring the entity to be duly organized prior to signing the allocation agreement may make much more sense.

Obviously, this can create some problem because of certification for CDE purposes, but the two could easily be tied two together for entities set up solely for NMTC purposes.

2. Also under the Eligibility section is the phrase “directly serving low-income communities”. There are current CDFI’s that do not directly serve low-income communities. They, instead, act as intermediaries. However, under Section 45D(c)(2)(B) CDFI’s automatically qualify as CDE’s. In addition, the term “directly” does not appear in the statute. To remedy the contradiction, we suggest inserting “or indirectly” in the text of the Guidance.
3. Also under the Eligibility section, the Guidance, referring to boards or advisory boards states that “members who are directly representative”. This may be more a problem of definition. We are not clear as to who determines who is directly representative. Is it only elected officials? We request that CDFI clarify this requirement.
4. Also under the Eligibility section, the Guidance discusses the BEA program. In this section it appears to prohibit banks from getting the NMTC and a BEA award if the bank itself is a CDE, but not if it is not. We do not understand why CDFI has made such a distinction.
5. Under Section V. Evaluation, we are particularly concerned with the time CDFI will require to perform the evaluations. We understand that the CDFI Fund has a fiduciary responsibility to underwrite these allocations, but these should be considered to be business deals with a social component to be underwritten. The NMTC Program is not a grant-making program used to support an economic development sector. This should be an underwriting process. The eligibility of the applicants in terms of social benefit is only another piece of the underwriting process.

First, the use of outside readers is unlikely to be necessary. The SBA has not employed such a panel in evaluating SSBIC applications and is not doing so in the New Markets Venture Capital Program. What is being reviewed is a business deal, not a grant award. The readers panel has generally been held three to four months after the application deadline. Not having to arrange and hold this meeting could conceivably save four months.

Second, are site visits necessary? Do they really add to the decision-making? If they do, do you need to have site visits on everyone, even though the CDFI Fund has performed previous site visits. Can they be done by telephone as the regulations allow?

Again, the NMTC should be considered a business transaction and not a philanthropic transaction. As such, time is a very important commodity. The following is a comparison of alternative timelines:

	<b>Evaluation Mirror Core Component</b>	<b>Alternative Evaluation</b>
December	Applications received	Applications received
January	Rejections for technical issues	Internal review and rejections for technical reasons
February	Logistics for readers panel	Continued underwriting
March	Readers panel	Committee decides
April	Internal review	Allocations Awarded
May	Site visits	
June	More Site visits	
July	Internal review	First Allocation Agreements signed
August	Committee decides	
September	Allocations Awarded	
October		
November		
December		
January	First Allocation Agreements signed	

The alternative evaluation schedule allows for three to four months to underwrite. I understand the volume of applications that the fund will receive is likely to be large, but that does not negate the fact that this should be a business decision.

To allow for a smoother year, the CDFI Fund may wish to consider having two allocations windows each year.

Finally, we hope that negotiating the allocation agreement will be much simpler than negotiating Core agreements. Program measures should be much more vanilla and consequently quicker to negotiate.

Our concern with the allocation process is that CDFI will expect CDE's to present them with comprehensive business plans, including likely, if not committed, investors as part of the CDE's application. It is not reasonable, and does not make business or economic sense for these transactions to be put together and then put on hold, for at least a year, while CDFI proceeds through an overly long and cumbersome allocation process.

## **Pending Issues**

### **Question 1**

**IRC section 45D(f)(2) requires that in making allocations of NMTCs, priority be given to: (a) any applicant that has a record of having successfully provided capital or technical assistance to disadvantaged businesses or communities or (b)**

**any applicant which intends to satisfy the Substantially All Test by making Qualified Low-Income Community Investments in one or more businesses in which persons unrelated to the CDE hold a majority equity interest.**

**(a) How should the Fund implement this policy? For instance, should the Fund incorporate preference points into the scoring? Should the Fund make awards to organizations that are deemed competitive and meet one or both of these criteria before providing an allocation to any other applicant?**

Depending on the other scoring methods used by CDFI in determining the allocations, CDFI will want to ensure that both criteria mentioned above have enough weight that those applicants that are given some kind of priority and are competitive, are awarded an allocation. CDFI probably does not want to be in a situation where all these applicants are beaten out by better financed applicants, with CDFI apparently ignoring the priority in the statute. How CDFI gets there is, to some degree, beside the point.

**(b) What specific factors should the Fund consider when evaluating whether an applicant meets the requirements for priority treatment?**

Under the track record, the Guidance previously stated, "the Fund will consider the track record of the entity controlling the CDE." In determining this you would look at activity in qualified areas from previous periods. The second test is a little cleaner. We suspect that applications will be made for single purpose transactions where a CDE intends to fund a related business. This could be either a Walmart type or CDC transaction. We don't have a philosophical problem with either of those, but the statute clearly had those in mind. We do not think venture transactions should be included with the previous two. Clearly a venture fund may acquire controlling ownership in a qualified business, but this usually occurs in default situations. As long as this is the case, where ownership is gained to help protect the fund and not in the usual course of business, there should not be a preference against this transaction.

**(c) Should more weight be given to one priority over the other and should an applicant be allowed to receive preference points under both priority categories?**

We are not sure how to prioritize either category. The question regarding points presupposes that CDFI has already made a decision on question 1(a). CDFI should carefully weigh its options, to ensure that the priorities result in allocations awarded to these applicants.

## **Question 2**

**Should there be limits as to the amount of a NMTC allocation that may be awarded to an applicant in a calendar year?**

The NMTC Program is very different from CDFI's other programs. CDFI must evaluate its options very closely before it decides to limit awards because of the transactional business nature of the program. Some structures and transactions will not work with only a prorated portion of the NMTC. Instead CDFI may want to set caps per applicant. These could be set to very large numbers, because of the size of the total allocation amounts, but would ensure organizational diversity. CDFI will likely also want to maintain geographic diversity, which will add some additional limits. The Fund may also

want to consider diversity in terms of organization sizes and project types, for example:

Small local	Mid-sized regional	Large regional/national
Debt fund	Venture fund	
Revolving fund	Single-purpose fund	

### **Question 3**

**During the evaluation process of NMTC applications, the Fund will request that applicants provide information on their track records for providing capital or technical assistance to Low-Income Communities and disadvantaged businesses and the effect that such investment/technical assistance has had on such Low-Income Communities or businesses. Applicants may also be required to describe the social underwriting criteria that they will use when deciding which companies to invest in. If an applicant receives a NMTC allocation, it will be required to report to the Fund on the ways in which the Qualified Equity Investments are used to benefit Low-Income Communities**

#### **(a) What indicators should the Fund assess when evaluating the community development impact of an applicant's prior activities or the social underwriting criteria of its loan policies?**

Any evaluation of an NMTC application should take into account that many of the indicators utilized to assess program outcomes lack specificity and that such outcomes are often situational, as it is virtually impossible to assert a causal link between the program intervention and the outcomes realized by the program beneficiaries. (for more see "From the Field: A Practitioner's Perspective on Program Monitoring" attached) With this in mind, assessments of an applicant's prior activities and/or social underwriting criteria should take into account the following aspects:

- Geographical area in which lending activities have been focused, paying specific attention to what percent of an organization's assistance have been targeted to low- and moderate-income communities and to communities facing a documented current or historical gap in the provision of financial and technical services;
- Documentation verifying beneficiaries inability to obtain financial and technical services from other sources;
- Race, ethnicity, and gender of loan recipients; and
- Employment and wage outcomes for employees at companies receiving financial assistance including a proxy for hours worked by part-time, full-time, seasonal, and temporary workers such as employee hours and change over time for each of these variables for the portfolio as a whole and for companies remaining in the portfolio over a number of years.

These indicators provide an understanding of the outcomes associated with an NMTC applicant's activities. Other indicators of organizational effectiveness and stability may be derived from sustainability ratios, audit performance, board composition, diversity of funding streams, previous history managing public and private investment vehicles, and

performance relative to specific investment targets such as number of loans closed and dollar amount of loans closed over time. It is important that these be considered in conjunction with an organization's stated mission and method of delivering services. For example, an organization focused on building capacity among new microentrepreneurs will have very different outcomes than one focused primarily on providing financing to new and existing companies regardless of size.

**(b) On what basis should the Fund judge how “successfully” capital or technical assistance has been provided?**

With reference to 3(a), CDFI should use the above type of information to develop both quantitative and qualitative measures, in evaluating past performance of applicants. Comparisons, however, will be extremely difficult, as CDFI will not be looking at one universal measure (e.g. EPS) but at myriad measures, most of which will have very different meanings for the different applicants, different missions, different geographies and customers.

**(c) What information should the Fund request from allocation recipients as indicators for evaluating the effectiveness of the NMTC Program (e.g., number of jobs created or retained, increase in revenues of businesses receiving Qualified Low-Income Community Investments, rates of return to investors from Qualified Equity Investments, or number of clients served at facilities that are developed)?**

Again, with reference to 3(a), there are many different types of measures CDFI could choose to use in evaluating the effectiveness of the NMTC Program. Some of the measures are easy to quantify and relatively universal (e.g. number of loans closed and dollar amount of loans closed over time), although they do not really measure outcomes. However, trying to measure outcomes is extremely problematic. “Jobs created or retained” and “increase in revenues of businesses” are not outcomes that can be causally linked with the activities of a CDE (unless you are referring to the employees of the CDE). The economy and even small businesses are such complex entities with so many inputs, that establishing causality is near impossible. Jobs in and of themselves are extremely bad measures as there is no time component related to “job”. A job for 30 years would probably have more value than one for 30 days. Similarly, “job” adds no description as to the quality of the job.

In addition, conditions in local economies around the country are so different that attempting to use any of the less quantitative measures and applying them universally becomes problematic. Is a high-paying job with benefits in New York of more value than a minimum wage job in Appalachia?

Ultimately, the purpose of the NMTC Program is to increase the supply of commercial capital to underserved parts of the country. Documenting those deficits and the ways CDE's use NMTC funds to narrow those deficits and provide capital in those markets would probably be the best way for CDFI to begin the evaluation of the program. CDFI may then wish to supplement this with more discreet and anecdotal information. However, CDFI should be careful to concentrate on the overall objectives of the NMTC

Program rather than becoming marred in traditional problematic economic development methodologies.

As we have recommended to the IRS, we request that CDFI, in writing the regulations, carefully consider its options, and work to implement a program that will achieve its intended objectives. We appreciate the opportunity to comment on the Guidance and thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'Richard Campbell', written over a horizontal line.

Richard Campbell  
CFO & VP/Operations

Cc: IRS  
Eric Solomon

enclosure

# From the Field: A Practitioner's Perspective on Developments in Program Monitoring

Garrett Martin  
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*Efforts to improve and standardize evaluation practice among Community Development Finance Institutions (CDFIs) have the potential to advance the CDFI movement and enhance its effectiveness. Improved evaluation practice will provide a better understanding of the degree to which program objectives are being accomplished and intended beneficiaries are being reached. Equally important, effective evaluation offers important opportunities to improve program functioning and potentially deepen the impacts of the CDFI movement. Shortcomings of the current discussion on evaluation practice must be overcome in order to insure that resources are effectively allocated and that efforts to standardize key indicators most accurately reflect the impacts of CDFI practitioners. This document attempts to identify those issues and suggest ways for practitioners to proceed. Call out boxes provide additional insight into specific measurement issues and reveal some of the problems associated with existing indicators.*

## Introduction

As the Community Development Finance Institution (CDFI) movement matures beyond its infancy, improvements in evaluation practice have the potential to provide a number of benefits. For practitioners, enhanced documentation of program outcomes and a common set of key indicators may simplify reporting requirements and provide a more unified voice with which to report the contributions of CDFIs to community and economic development. Investors and donors will have a better basis by which to compare organizations and make investment decisions as well as to gain more comprehensive knowledge of the impact of their investments. Ultimately, this effort may expedite the flow of additional investments into CDFIs and promote learning within and across organizations that will provide important opportunities for CDFIs to improve program functioning and effectiveness.

Current efforts to promote improvements in evaluation practice center on standardization of key indicators and improvements in internal capacity to conduct monitoring efforts. Although it remains impossible to fully capture the diverse experiences and activities of individual organizations with a set of common indicators, it is nonetheless useful to create a common language and set of metrics that provide insight into the impacts and activities of CDFIs. In order to optimize



the effectiveness of efforts to improve evaluation practice, practitioners and investors should consider the following issues as they move forward:

- Flaws associated with current indicators
- Difficulties establishing causality
- Lack of internal capacity of organizations to conduct ongoing evaluation

**Do Existing Indicators  
Accurately Reflect the Scope of a  
CDFI's Activities and Impacts?**

Among CDFIs that focus on business lending, the most commonly reported indicators include:

- Number of jobs created or retained
- Number of jobs filled by low-income individuals
- Number of minority and women owned businesses assisted

**Creation, Retention – What's the Difference?**

What's the difference in impact between a CDFI that finances a start-up that creates 50 new jobs and a CDFI that finances an existing company that currently employs 50 people but would have gone out of business without financing?

While some organizations provide separate counts for the number of jobs created and retained at assisted businesses, most report impact in terms of jobs assisted. In the example above, both CDFI's would report 50 jobs assisted.

The combination of creation and retention counts into a single indicator is a form of linguistic jujitsu that stems from the following sources:

- CDFIs do not create or retain jobs, they assist businesses where jobs are created or retained.
- In many instances it is nearly impossible to assert the relative merits of retaining jobs versus creating jobs.

While retention numbers can be more easily inflated by targeting companies that employ large numbers of people and do not have a critical need for financing, the combination of retention and creation numbers into a single indicator provides a more comprehensive assessment of a CDFI's contribution to local employment.

Job creation and retention numbers are often combined into a single measure such as jobs maintained or assisted and suffer a variety of pitfalls. First, neither indicator provides insight into the quality of the jobs they measure. Jobs that pay above minimum wage and include a wide range of benefits count the same as jobs that pay minimum wage and include no benefits. Second, job creation and retention numbers say little about longevity of a job and are subject to being inflated. For example, the employment impact of a start-up that hires 20 workers today and goes out of business tomorrow is reported the same as a start-up that hires 20 workers today and stays in business indefinitely. Other indicators such as a measure of full-time equivalents or employee hours may provide a more accurate snapshot of a CDFI's contribution to employment. Finally when job numbers are viewed in combination with other indicators such as an organization's ability to leverage funds from other sources, they are even less reliable as a means of comparison. The

### **The Conundrum of Job Quality**

What's the difference between a minimum wage job with no benefits and a job that pays \$1.50 above minimum wage, provides health insurance and opportunities for advancement?

A lot. Unfortunately, in the rush to quantify the number of jobs, measures of job quality are often overlooked. Determinants of job quality may include:

- Salary levels
- Benefits including health, disability, retirement, and child care
- Working conditions

While job quality can be situational and subject to the economic context in which an organization functions, it is an important facet of a CDFI's impact. In fact, some organizations make the promotion of "quality" jobs their primary focus. How these organizations are evaluated raises a critical question about the priorities of the CDFI movement.

impacts of a CDFI that assists in the creation of 1,000 jobs by contributing \$10,000 to 10 deals of \$100,000 each are difficult to compare with the impacts of a CDFI that creates 100 jobs by investing \$100,000 into a single deal of \$100,000.

Income status of job recipients presents another challenge. The need to insure that low- and moderate-income individuals benefit from the activities of CDFIs is well-grounded. However, *household* rather than individual income most accurately reflects the economic

status of a particular worker, and household income is difficult to measure. Additionally, the focus on income ignores the fact that a large number of beneficiaries for some business lenders are existing employees who might not have a job without the CDFI's assistance. While low-income individuals are the intended beneficiaries of CDFIs, it is important to acknowledge the difficulties associated with promoting quality jobs while continuing to have an impact on low-income workers. Unskilled, low-income workers often fail to qualify for higher paying jobs with benefits.

### **Inflating the Numbers**

Would a tally of all the reported job creation and retention of economic development projects around the country reveal an excess supply of jobs for years to come?

Probably. Consider the following two scenarios:

Scenario 1: A CDFI finances a business that opens today, hires 20 people, and closes tomorrow leaving those employees without a job.

Scenario 2: A CDFI finances an existing firm that has 50 employees. The firm purchases new equipment that reduces the number of employees to 15.

On paper, that's a total of 20 jobs created + 50 jobs retained = 70 jobs assisted.

In reality, 15 people go to work.

While organizations may not consciously inflate job statistics, existing indicators fail to depict certain nuances associated with job counts including longevity of a job opportunity and changes in employment over time. For this reason, the impact of a start-up that hires 20 people and stays in business for 30 years is recorded the same way as the business in Scenario 1.

This problem is not specific to CDFIs as many private and public economic development organizations count job numbers in the same way and further inflate the numbers by applying multipliers that represent additional jobs created to support and respond to the increased demand for goods and services as a result of the new jobs. In the example above, applying a standard multiplier of 2 meaning that for every job assisted an additional job is assisted elsewhere in the economy, an economic development agency may report 140 jobs assisted.

### **What are the Benefits and Challenges to Establishing Causality?**

Studies concerned with causality seek to answer the following questions:

- What would happen if the CDFI did not exist?
- What portion of a CDFI's reported impact can be attributed to that CDFI's activities?

Establishing a causal link between an organization's intervention and the outcomes it achieves offers the following benefits:

- Provides a clearer understanding of the role that a CDFI plays in providing opportunities for intended beneficiaries
- Enhances the ability of a CDFI to attribute specific impacts to specific interventions
- Offers evidence that justifies the allocation of public and private resources to CDFIs

Individual CDFIs may wish to include proxies for causality in their efforts to monitor program outcomes by including questions that allow borrowers to identify the degree to which financing enabled them to stay in business or expand operations. This is especially important since statistically valid studies of causality are costly and require rigorous research method and design. Most organizations lack the scale and resources to conduct such studies. Even in a large, well-funded organization such a study creates an ethical conflict since it requires the establishment of a control group. This would entail denying services to otherwise qualified borrowers, which contradicts the mission of CDFIs.

Aside from these challenges, the current focus on causality is skewed because funders often rely on outside experts to conduct these studies. This undermines the benefit of such efforts to the individual CDFI in terms of developing capacity to conduct ongoing analysis and utilizing the results in a manner that promotes learning and informs program practice. In addition, the value of such studies to the CDFI movement are limited since the findings of one study that focuses on a particular CDFI operating in a given context may not be applicable to other CDFIs operating in other environments. More basic issues such as limitations associated with current indicators, data collection and analysis should be addressed before attempting to undertake more complex and costly studies of causality.

### Why is it Important to Build Internal Capacity for Evaluation?

CDFIs need to develop their internal capacity to monitor and analyze program outcomes. While external evaluators have played an important role in developing instruments and methods of evaluation, the ability to conduct monitoring efforts in-house offers a number of benefits. These include:

- Development of systems that reflect organizational priorities and needs
- Increased use of evaluation results to inform program practice
- Enhanced capacity to follow-up on evaluation results

An organization that develops its capacity for evaluation is more likely to incorporate the process and results into daily practice. First, the time and resources required to develop an effective monitoring system increases that CDFI's stake in the outcomes and their use. Second, by conducting evaluation in-house, CDFIs are in a better position to incorporate the measures and processes associated with evaluation in a manner that is coherent with their overall mission and approach as well as the needs of their clients. In addition, they are in a better position to follow-up with clients and have a unique interest in doing so.

#### The Truth about Internal Capacity

Who is promoting internal capacity and how?

In recent years evaluation has received much attention from donors with conferences and grants to assist CDFIs in creating "internal learning systems", exchange visits among practitioners, etc. Ironically, when a donor really wants to evaluate a program they hire outside experts to conduct a study.

Internally, practitioners claim to be strapped for the time and resources necessary to conduct evaluation in an ongoing manner. As a result, the method and outcomes of evaluations are less likely to be used to inform organizational practice and more likely to be used to fulfill reporting requirements and for marketing purposes.

### Moving Forward

In light of the discussion above, following is a list of recommendations intended to inform future efforts to improve evaluation practice:

- **Proceed with caution in setting standards:** The drive to standardize must continue to come from funders and CDFI trade associations who have the resources and leverage necessary to bring such an initiative to fruition. Although time consuming, it will be important to incorporate the voices of practitioners in the discussion and to foster innovation in the identification and analysis of more reliable indicators particularly with regard to the assessment of individual and community level impacts.

- **Fight the battle of causality another day:** The resources and challenges associated with conducting valid studies of causality undermine the value of such studies to the CDFI movement. Practitioners should be encouraged to develop proxies for causality; however, more basic issues related to data collection and analysis should be addressed before attempting to undertake more rigorous studies of causality.
- **Walk the talk with regard to building internal capacity:** CDFI practitioners and funders must devote the time and resources necessary to monitor outcomes. Building such capacity offers long-term benefits to the organization and establishes an appropriate balance between efforts to monitor financial performance and to measure impact.
- **Focus on analysis and on optimizing learning:** Much of the focus on improvements in evaluation practice address front end issues; however, an important benefit associated with program monitoring comes from the learning and improvements in program effectiveness that can occur through rigorous analysis and incorporation of evaluation results into program practice. In addition, the development of innovative methods of analysis may enable an organization to more accurately portray the scope of its activities and to incorporate its priorities into evaluation results.

### Conclusion

At its most basic level program monitoring helps to insure that CDFIs are accomplishing program objectives and reaching their intended beneficiaries. In much the same way as CDFIs report on a standard set of fiscal indicators, they should also report on a standard set of impact indicators adapted to their focus area: business lending, housing, or community facilities for example. Developing the most meaningful indicators and incorporating them into a system that truly informs program practice will take a great deal of time and effort. Fortunately a number of organizations have begun the task of capturing lessons learned and disseminating information on standard practice. Such initiative should be viewed as an opportunity to forward the CDFI movement as a whole and to capture the wealth of experiences being had by CDFIs across the country.

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